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JUL 1 1994

FEDERAL COMMUNICATIONS COMMISSION
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Before The
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation	)	MM Docket No. 93-215
	)	
and	)	
	)	
Adoption of a Uniform Accounting System for Provision of Regulated Cable Service	)	CS Docket No. 94-28

COMMENTS OF LIBERTY MEDIA CORPORATION

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SUMMARY

The Commission proposes to reverse course and to adopt revised cable affiliate transaction rules which will substantially limit the "prevailing price" method for establishing the fairness of affiliated transactions. As set forth in the accompanying "Economic Analysis of the Proposed Change in the Cable Television Affiliate Transaction Rule" by Robert W. Crandall, "analysis of the benefits and costs of this proposed rule reveals that the change would be harmful to consumers."

The Commission's proposal ignores the narrow application of the telco affiliate transaction rule and the fundamental differences between the telco and cable industries. In applying the telco rule, the Commission has defined "affiliated companies" to require "common control." In contrast, the affiliation standard for cable is based on a 5 percent ownership interest of virtually any kind in the "affiliated" entity. Thus, numerous cable operators are affiliated with programmers by virtue of minority ownership interests, and often more than one cable operator is affiliated with the same programmer. Because the Commission has classified programming as an "asset," cable operators will have numerous asset transactions subject to the affiliate transaction rule while telcos typically do not.

The proposed telco affiliate transaction rule is particularly inappropriate for cable programming affiliates. Clearly, the "predominant purpose" of affiliated cable programmers is not at issue -- they are statutorily required to

and do provide their programming services to multichannel video programming distributors whether or not affiliated. Nonetheless, numerous widely distributed programming services, including BET, CNN, Court TV, Discovery, E! Entertainment, Headline News, the Learning Channel, and TNT, apparently would fail the 75 percent unaffiliated sales test even though each has sales of the identical programming service to innumerable unaffiliated cable systems.

Based upon his review of cable operator and programmer ownership and incentives, Dr. Crandall concludes that the Commission's proposed revisions also are unnecessary. "It is unlikely that the typical vertically integrated cable system would have the incentive and ability to inflate affiliated programming prices...."

If cable operators cannot use prevailing company prices to validate affiliated transactions, the Commission's proposal would require that they set the cost of the programming at the lower of the programming's estimated fair market value or the programmer's net book cost. Both of these alternatives involve subjective and costly evaluations which will be burdensome to cable operators, programmers, the Commission, and innumerable local franchise authorities.

The proposed cable affiliate transaction rule will sacrifice the recognized public interest benefits of cable operator investments in programming. Both Congress and the Commission have concluded that there are substantial benefits to program quality and diversity resulting from vertical integration. However, if the Commission adopts its proposed cable affiliate transaction rule, the burden and cost of valuing affiliated programming would increase dramatically. Further, non-controlling investments by multiple cable operators, enabling the spreading of these admittedly high-risk investments, would be discouraged. Most importantly, by eviscerating the "prevailing price" test and requiring cable operators to sell affiliated programming at the programmer's net cost, the Commission will limit the rate of return for successful services, thereby creating a significant disincentive to vertical integration.

The Commission also should abandon consideration of its proposed productivity offset. There was no record evidence to support an offset of any magnitude based on productivity gains from technological advances, and it is unlikely that cable operators will be able to maintain current levels of investment in plant and technology because of the mandated rate reductions. In any event, the Commission properly has concluded that programming costs should be excluded from any productivity offset. There is no basis reasonably to expect that programmers, whose costs are largely for talent and intellectual property, will experience significant efficiencies and cost savings from technological innovation.

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COMMENTS OF LIBERTY MEDIA CORPORATION

Liberty Media Corporation ("Liberty Media") submits these comments and the annexed "Economic Analysis of the Proposed Change in the Cable Television Affiliate Transaction Rule" by Robert W. Crandall ("Crandall Report") in response to the Further Notice of Proposed Rulemaking in this proceeding.[1] The Commission should abandon further consideration of the proposed telco rules for cable affiliate transactions and of any productivity offset, particularly one for cable programming costs.

Introduction

The Commission has changed the treatment of affiliated programming costs more frequently than perhaps any other

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[1] See Report and Order and Further Notice of Proposed Rulemaking, MM Docket No. 93-215, CS Docket No. 94-28, FCC 94-39 (rel. Mar. 30, 1994) ("Report and Order" and "Further Notice").

element of its rate regulations. In its initial Rate Order, the Commission limited the pass-through of affiliated programming cost increases to no more than inflation. First Report and Order, MM Docket No. 92-266, 8 FCC Rcd. 5631 (1993), at ¶252. The Commission properly reconsidered this decision in its First Reconsideration Order and permitted cable operators to pass through the costs of affiliated programming as external costs as long as the prices charged to the affiliate reflect either prevailing company prices offered in the marketplace to third parties or the fair market value of the programming. First Order on Reconsideration, MM Docket No. 92-266, 9 FCC Rcd. 1164 (1993), at ¶114.

The Commission further refined its treatment of the costs of affiliate programming, which it classified as an "asset," in this proceeding and introduced an additional layer of complexity:

> [F]or the purpose of establishing initial costs for programming purchased by a cable operator from an affiliate, the cost of the programming shall equal the provider's prevailing company price, if the provider has sold the same kind of programming to a substantial number of third parties at a generally available price. Absent a prevailing company price, the cost of the programming shall equal the lower of the provider's net book cost and the programming's estimated fair market value.

Report and Order at ¶267. However, the Commission expressly recognized that "affiliate transactions will usually be set at the prevailing company price, because the record indicates that affiliate transactions in the cable industry primarily involve purchases from affiliated programmers who sell the same products to third parties." Id. at ¶265.

In the same Report and Order, the Commission effectively proposes to scrap the rules which it just adopted after a careful analysis of the record and to substitute revised rules based on its proposed telco affiliate transaction rules. The Commission simply states its tentative conclusion that "the general changes we have proposed for telephone companies should be applied to cable operators as well." Report and Order at ¶310. In contrast to the "detailed analysis of each of these transaction methods for telephone companies,"[2] the Commission has no experience with its present cable affiliate transaction rule and has documented no comparable analysis in its 2½-page Further Notice.[3]

This latest proposal would require the Commission to reverse course without any record support or reasoned basis. Application of the proposed telco rules to cable ignores the substantial differences in the relevant affiliation standards, the industries, and the nature of affiliated transactions.

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[2] In the Notice of Proposed Rulemaking for its telco rules, the Commission refers to "over six years of experience in applying these valuation methods." The Commission explains that this "experience" has enabled it to "analyze the bases for and practical effects of the present methods in far greater detail...." Notice of Proposed Rulemaking, CC Docket No. 93-251, 8 FCC Rcd. 8071 (1993), at ¶9.

[3] Liberty Media takes no position regarding the propriety of the Commission's proposal to amend the telco affiliate transaction rule. As set forth infra at 4-9, the Commission uses a substantially different affiliation standard in applying its telco rules, and the nature of the affiliations and affiliated transactions appears to be fundamentally different.

The proposed revisions also would result in substantial costs and burdens for cable operators and programmers, the Commission and innumerable local franchising authorities without any benefit to consumers. The Commission should promptly terminate this proceeding so that cable operators and affiliated programmers can implement the present rules with the certainty that the Commission will not change course yet again.

I. The Affiliate Transaction Rule Is Narrowly Applied To Telcos And Was Developed For A Fundamentally Different Industry.

In applying the telco rules, the Commission has defined "affiliated companies" narrowly to include only "companies that directly or indirectly...control or are controlled by, or are under common control, with the accounting company." 47 C.F.R. §32.9000. By requiring such "common control,"[4] the Commission has significantly limited the scope of its telco affiliate transaction rule and at least attempted to target

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[4] The Commission has defined "control" (including the terms "controlling," "controlled by," and "under common control with") as:

> [T]he possession directly or indirectly, of the power to direct or cause the direction of the management and policies of a company, whether such power is exercised through one or more intermediary companies, or alone, or in conjunction with, or pursuant to an agreement with, one or more other companies, and whether such power is established through a majority or minority ownership or voting of securities, common directors, officers, or stockholders, voting trusts, holding trusts, affiliated companies, contract, or any other direct or indirect means.

47 C.F.R. §32.9000.

those affiliated relationships which might be subject to potential abuse.

Clearly, the original telco affiliate transaction rule and the Commission's recent proposal to revise it were founded on their limited application to commonly controlled entities. Thus, in proposing its original affiliate transaction rule, the Commission sought to regulate transactions "between separate subsidiaries and any other affiliates" and "between regulated telephone operations and nonregulated divisions or affiliates." Separation of Costs of Regulated Telephone Service from Costs of Nonregulated Activities, CC Docket No. 86-111, 104 F.C.C.2d 59 (1986), at ¶76. Consequently, the Commission questioned whether it "should ever assume that carriers are free to deal at arm's length with their parent corporations, commonly-controlled affiliates, or subsidiaries." Separation of Costs of Regulated Telephone Service from Costs of Nonregulated Activities, CC Docket No. 86-111, 2 FCC Rcd. 6283 (1987), at ¶131. Again, in proposing to revise the telco rules, the Commission reasoned that "[a]ffiliate transactions take place in a different environment" -- "[b]ecause affiliates are under common control, they are often captive customers of each other." Notice of Proposed Rulemaking, CC Docket No. 93-251, 8 FCC Rcd. 8071 (1993), at ¶18 (emphasis added).[5] In contrast, under the cable affiliate transaction rule:

> [A]n entity is affiliated with a cable system operator when it has a five percent or greater ownership interest in the cable system operator. That definition also specifies that a cable system operator is affiliated with another entity when it has a five percent or greater interest in that entity and that two companies that do not own each other are affiliates when a single entity has a five percent or greater interest in each of the two companies.

Report and Order at ¶313 n.577.[6] Thus, any ownership interest of 5 percent, even if a non-voting stock or limited partnership interest or held in an entity with another single controlling shareholder, meets this affiliation standard. Id. at ¶269; see 47 C.F.R. §76.1000(b). In the context of its program access and anti-discrimination rules, the Commission originally adopted this standard because its "policy objective...warrants a relatively inclusive attribution rule."

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[5] The underlying importance of the Commission's control standard of affiliation to its telco proposal is confirmed throughout the Notice of Proposed Rulemaking. For example, the Commission refers to an "affiliate group," which it defines as "all entities that directly or indirectly control, or are controlled by, or are under common control with a carrier." Notice of Proposed Rulemaking, CC Docket No. 93-251, 8 FCC Rcd. 8071 (1993), at ¶11 n.15. Clearly, the "affiliated group" concept has no application under the cable affiliate transaction rule.

[6] Notwithstanding its wholesale adoption of its telco proposal, the Commission proposes "to retain the definition of affiliate that we adopt in the Report and Order." Report and Order at ¶313. Further, the rule would apply to all affiliated cable operators, i.e. operators "who either elect cost-of-service regulation or seek to adjust benchmark/price cap rates for affiliated programming costs." Id.

First Report and Order, MM Docket No. 92-265, 8 FCC Rcd. 3359 (1993), at ¶31.

Clearly, this "inclusive" affiliation criterion expands the scope and burden of the cable affiliate transaction rule far beyond the narrow and "different environment" to which the telco rules apply. The causative factor of "control" underlying the Commission's proposed revisions to the telco rules is plainly absent. Cable operators simply are not "captive customers" of the programmers in which they have small and non-controlling investments -- programmers competing in "a market in which there is abundant and increasing competition." First Report and Order, MM Docket No. 92-266, 8 FCC Rcd. 5631 (1993), at ¶8.

Of the 46 cable programming services analyzed by Waterman and Weiss in 1993, cable operators had ownership interests of 5 percent or more in 26 services. D. Waterman and A. Weiss, "Vertical Integration in Cable Television" presented to American Enterprise Institute for Public Policy Research (Sept. 17, 1993) at Table 2-2. At least 12 cable operators held attributable interest(s) in one or more cable programming services.[7] By definition, only one telco can be "affiliated" with, i.e. control, a given entity. However, two or more cable operators held attributable ownership interests

[7] Under the cable affiliation standard set forth supra at 6, these "cable operators" also may have attributable interests in innumerable other cable operators. For example, Liberty Media has ownership interests of 5 percent or more in 19 entities providing cable television service.

in 14 of the services analyzed by Waterman and Weiss, and three or more operators held attributable interests in six of those services. Id. at 23. Thus, the cable affiliate transaction rule potentially applies to a large number of programming purchases, placing excessive burdens upon cable operators, programmers and the Commission.

Telcos subject to the Commission's affiliate transaction rule have confirmed that "asset transfers between regulated and nonregulated operations occur infrequently." Comments of BellSouth Telecommunications, Inc. ("BellSouth") at 10; see Reply Comments of Pacific Bell and Nevada Bell at 5 ("there have been few asset transfers").[8] Consequently, "there have been very few asset transfers subject to the estimated fair market value requirements of the current rules," and those "assets, by their nature, have been subject to reasonable market value estimating processes." Comments of Coopers and Lybrand at 1.

Again, in contrast to telcos, cable operators will have numerous "asset" transactions with affiliates because the Commission has "classified" programming as an "asset." Report and Order at ¶267. If the current rules are retained and the prevailing price mechanism is available, valuing such asset transactions is straightforward. Virtually all programmers, including those with multiple affiliated owners, may utilize

[8] Unless otherwise stated, references to "Comments" and "Reply Comments" on the telco affiliate transaction rule are to comments and reply comments filed in CC Docket No. 93-251 on December 10, 1993 and January 10, 1994 respectively.

"prevailing company prices" based on substantial sales to third parties. Indeed, under 47 C.F.R. §76.1002, affiliated programmers are required to offer their programming services to third-party "multichannel video programming distributors" on non-discriminatory prices, terms and conditions. Further, because the marginal costs incurred in providing programming are low, affiliated programmers have an incentive to make third-party sales. Finally, because the same programming service is distributed to multiple cable operators, non-affiliated sales provide a particularly reliable indicator of fair market value.

II. The Proposed Telco Affiliate Transaction Rule Is Particularly Inappropriate For Cable Programming Affiliates.

In simply extending its telco proposal to cable operators, the Commission tentatively concluded that "prevailing company pricing for affiliate transactions should only be utilized where the predominant purpose of the non-cable affiliate in the transaction is to serve non-affiliates." Report and Order at ¶310. The commission proposes to require that an affiliate sell "at least 75% of its output to non-affiliates" to allow use of the "prevailing company pricing" test. Id. at ¶311.

Virtually every telco commenter contended that the Commission's proposal to eviscerate the "prevailing company price" criterion was inappropriate. Telco commenters uniformly attacked not only the Commission's 75 percent output requirement for determining an affiliate's "predominant purpose," but also the reasoning underlying that test:

> The stated purpose of this exercise is to classify those affiliated entities whose "predominant purpose" is to serve nonaffiliates. The exercise is meaningless because the inquiry should be whether a prevailing price for the asset or service has been established through sales in the market, not the relationship between the carrier and the affiliate.
>
> The percentage of output provided to nonaffiliates is irrelevant to the establishment of a prevailing market price, regardless of what percentage is chosen. It is the selling entity's market price -- what others are actually paying -- which should be the focus of the inquiry. It is the existence of a nonregulated, competitive market for the products and services in question that determines a market price or prevailing price.

Comments of Southwestern Bell Telephone Co. ("Southwestern Bell") at 12 (notes omitted).[8]

The Commission's former Chief Economist explains in an expert statement submitted with AT&T's Comments that the Commission's requirement of 75 percent unaffiliated sales is unnecessary under market price theory:

> The 75 percent rule is also unnecessary under any economic theory. A market price is established if <u>any</u> significant group of market participants engages in arm's length transactions at that price. In particular, suppose that a significant group of customers buys a good or service at a certain price from an unregulated affiliate of AT&T. These transactions provide evidence that AT&T's regulated

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[8] <u>See</u> Comments of American Telephone and Telegraph Company ("AT&T") at 18; Comments of Ameritech Operating Companies at 19-21; BellSouth Comments at 20-23; Comments of GTE Service Corp. ("GTE") at 11-13; Comments of Nynex Telephone Companies ("Nynex") at 24-26; Comments of Pacific Bell and Nevada Bell at 10; Comments of Southern New England Telephone at 7-8; Comments of U.S. West, Inc. at 16-19; Comments of United States Telephone Association ("USTA") at 18-19.

> operations would have to pay at least that same price if they relied on external supply. Indeed, the next best source of supply, other than AT&T, may be at a higher price.

J. Haring & J. Rohlfs, "The Absence of a Public Policy Rationale for Applying Affiliate-Transaction Rules to AT&T" at 13 (emphasis in original). Instead, telco commenters point to the traditional definition of "market price" as the proper touchstone for evaluating affiliate prices -- the "price at which a seller is ready and willing to sell and a buyer ready and willing to buy in the ordinary course of trade." Southwestern Bell Comments at 12 n.45.

Liberty Media respectfully submits that the Commission's "predominant purpose" test and 75 percent unaffiliated sales requirement are particularly inappropriate for cable programming affiliate transactions. As the Commission previously has recognized:

> The exact nature of the [ownership] link varies considerably from network to network. For example, several programming networks have broadly based cable operator ownership participation, some are wholly owned by one or a few MSOs, and some networks have both MSOs and non-MSOs as part owners. This vertical integration has increased both the quality and quantity of program services available to the viewing public.

Competition, Rate Deregulation and the Commission's Policies Relating to the Provision of Cable Television Service, MM Docket No. 89-600, 5 FCC Rcd. 4962 (1990) ("Report to Congress"), at ¶78. Thus, "many popular cable networks now hav[e] ownership links with one or more MSOs." Id. at ¶77.

In short, in contrast to the telco rules where by definition the telco controls the unregulated affiliate, cable operators typically own non-controlling interests, often with other cable operators.[9] Clearly, the "predominant purpose" of the affiliated cable programmers is not at issue -- they are statutorily required to and do provide their cable programming services to multichannel video programming distributors whether or not affiliated. See Crandall Report at 9 ("[N]o useful conclusions regarding the incentive or the ability to inflate prices can be obtained by this artificial attempt to identify the purposes of cable networks that are affiliated with cable systems.").

Nonetheless, because of the Commission's "inclusive" affiliation standard, numerous widely distributed programming services would fail the 75 percent of output test if their cable investors carry the service to the same proportion of subscribers as do other cable operators. For example, BET, CNN, Court TV, Discovery, E! Entertainment, Headline News, the Learning Channel, and TNT apparently would fail the 75 percent unaffiliated sales test even though each has sales

[9] The Commission previously has recognized that "common ownership of a programming service by several MSOs may decrease the ability of any one MSO to assert influence or control" over that service. Second Report and Order, MM Docket No. 92-264, 8 FCC Rcd. 8565 (1993), at ¶63. See Crandall Report at 12 (Where more than one MSO has attributable interests in a program network, "[p]roblems that are likely to arise in attempting to reach a consensus on the increase in the license fee and to prevent affiliates from reducing carriage would reduce the likelihood of an attempt to raise license fees to evade cable regulation.").

of the identical programming service to innumerable unaffiliated cable systems. These differences in the affiliation standard and the nature of typical cable operator investment in "affiliated" programmers render the proposed telco rules inapplicable to cable affiliated transactions.

Based upon his review of cable operator and programmer ownership and incentives, Dr. Crandall concluded that the Commission's proposed revisions also are unnecessary:

> [I]t is unlikely that the typical vertically integrated cable system would have the incentive and ability to inflate affiliate programming prices because of the following: (i) For services in the basic tier, a cable system would lose its gross margin from sales of basic, expanded basic, pay, PPV, and other services to subscribers, as well as from advertising and home shopping, that would be lost as a result of the increase in the basic service price. (ii) The programming service would lose its gross margins on lost sales to nonaffiliated cable systems. (iii) The cable system often has only a partial ownership interest in the programming service, and hence receives only a pro-rata share of any increase in the latter's profits. (iv) If the cable system has multiple owners, and some owners are not affiliated with the programming service, the vertically integrated owner would face the problem of persuading the non-integrated owners to pay an inflated price for programming. (v) If more than one MSO has an ownership interest in the programming service, these MSOs would be likely to face problems in coordinating to evade regulation.

Crandall Report at 12-13. In short, there are no discernible benefits to offset the substantial costs and other burdens associated with the Commission's proposed rule.

III. The Commission's Alternative Valuation Methods Are Inappropriate For Cable Programming Services And Would Be Costly And Burdensome For Cable Operators And Programmers.

If cable operators cannot use prevailing company prices to validate affiliated transactions, the Commission's proposal would require that they set the cost of the programming at the lower of the programming's estimated fair market value or the programmer's net book cost. Both of these alternatives involve subjective and costly evaluations which will be burdensome to cable operators, programmers, the Commission, and innumerable local franchise authorities.

A. Estimated Fair Market Value

When the Commission first adopted fair market value as a method for valuing transferred assets under its telco affiliate transaction rule, it identified "methods of valuation which are readily available," such as "competitive bids, appraisals, market surveys, etc." Separation of Costs of Regulated Telephone Service from Costs of Nonregulated Activities, CC Docket No. 86-111, 2 FCC Rcd. 1298 (1987), at ¶295 n.469. Typically, in those "very few asset transfers subject to the estimated fair market value requirements" (see supra at 8), telcos can rely on the sales of comparable assets.

However, in adopting its current cable affiliate transaction rule, the Commission clearly identified the significant and unique problems in attempting to estimate fair market value of programming services based on sales of other "comparable" services:

> The difficulty of establishing comparability of assets, products, and services creates an inherent problem for a methodology that bases affiliate prices on prices that independent suppliers charge to third parties. This is particularly the case when the product is programming. What may appear comparable from a production viewpoint, for example, may in no way be comparable from the perspective of the program viewer. Thus, a low-cost production that provides the producer with a high price on the basis of high viewer demand may not be comparable to a similarly low-cost production with little viewer demand.

Report and Order at ¶268. Without "comparable" sales to rely on, fair market value estimates will be costly, inherently subjective, and difficult to audit. See Crandall Report at 17 ("Finally, fair market value is not a practical standard for pricing cable television programming services. ...Comparisons among networks would involve subjective judgments and present fertile ground for disputes.").

Indeed, in comments on the Commission's telco proposal to extend the fair market value requirement to services which present to a lesser extent this same "comparability" problem, Coopers and Lybrand concluded that:

> The proposed rules...create a complete new layer of work to value services, make it far more difficult for companies to determine whether they are in compliance with rules, add complexity and subjectivity to the audit process and render the company and auditor conclusions subject to continued debate because the market valuation of services adds substantial subjectivity to the rules.

Comments of Coopers and Lybrand at 2.

In addition to the limited usefulness of fair market value estimates, particularly for cable programming, their cost appears exceedingly high. Telco commenters consistently estimated costs of approximately $40,000 per transaction in estimating the fair market value of service transactions. See USTA Comments at 10; Nynex Comments at 19 ("an average of $35,000-$45,000"); Reply Comments of Pacific Bell and Nevada Bell at 4-5; GTE Comments at 2-3. USTA estimates that Tier I carriers would incur an additional annual expense of "approximately $91 million" in performing fair market value studies for services alone. USTA Comments at 10. Although Liberty Media previously has not conducted such studies, it appears that the costs, which consumers ultimately will bear, would be considerable.

B. Programmers' Net Book Cost

Cable operators face a threshold problem in utilizing this test. Unlike telco affiliates, which are under common control and typically are parent or wholly-owned subsidiary corporations, cable operators often have only minority interests in their programming "affiliates." Consequently, they cannot compel such studies by virtue of any control and, because of their investments in competing programmers, affiliates may be reluctant to provide detailed cost information.

In any event, identifying a programmer's "net costs" for an individual programming service also will be a difficult, subjective, and costly exercise. The following basic cost issues are examples of the kinds of difficult matters that must be resolved:

- There is no basis for treating cable programming costs in the same manner as telephone industry costs. The costs of attempting to impose cost-of-service regulation on cable programming would be much higher. The cost structure of the telephone industry is heavily weighted toward fixed plant and equipment, and many investments in the industry are lower risk. The structure of the programming industry is heavily weighted toward development, production, and marketing of programming.

- It would be difficult to allocate the costs of a programmer among individual services. Efforts to determine costs of individual motion pictures have been contentious. Talent may negotiate for shares in profits rather than current payments. Contracts may be front-loaded or back-loaded. The network may own its production and transmission facilities.

- Amortization of development costs also will pose difficult problems. Given the uncertainty about the success and life span of a network, decisions on amortization become arbitrary. Whatever the decision, the estimated cost per subscriber will fall if the network becomes successful and rise as the network fails. Thus, as the network becomes more successful, the cable system would have to reduce its rates to subscribers under the pass-through test. The incentive effects from such a result are obvious.

- As the Commission has recognized, the development of new cable programming services is very risky. Programmers constantly develop and market new programming concepts. Many of these projects are abandoned before launch, and a significant number of launched services fail.

See Crandall Report at 15-17.

Thus, the rate of return on a programming service must be sufficiently high to reflect that high risk. The determination and allocation of costs for programming services produced and distributed by programmers in which cable operator(s) have a non-controlling interest will be difficult, costly, and inherently less reliable than valuations based on the existence of a "substantial" number of like sales to unaffiliated cable operators.

IV. The Proposed Cable Affiliate Transaction Rule Will Sacrifice The Recognized Public Interest Benefits Of Cable Operator Investments In Programming.

The Commission must evaluate the costs and benefits of its proposal in the context of the recognized public interest benefits of vertical integration, i.e. cable operator investments in cable programming services:

> Congress and the Commission have both recognized that there are benefits which result from vertical integration. First, MSO investment has produced a wealth of high quality cable programming services. Many of the most popular cable programming services were initiated or sustained with the help of MSO investment. Second, vertical integration between cable operators and video programming services appears to produce efficiencies in the distribution, marketing, and purchase of programming. Third, vertical integration can reduce programming costs, which in turn may reduce subscriber fees and cable rates. Fourth, vertical integration may in certain circumstances foster investment in more innovative and riskier video programming services.

Second Report and Order, MM Docket No. 92-264, 8 FCC Rcd. 8565 (1993), at ¶68; Report and Order and Further Notice of Proposed Rulemaking, MM Docket No. 92-264, 8 FCC Rcd. 6828 (1993), at ¶202 ("we recognize that there are substantial benefits and efficiencies which derive from vertical integration...."). Thus, a number of the most "innovative programming services...would not have been feasible without the financial support of cable system operators." Cable Television Consumer Protection And Competition Act of 1992, H.R. Rep. No. 628, 102d Cong., 2d Sess. 41 (1992); see Amendment of Part 76, Subpart J, Section 76.501 of the Commission's Rules and Regulations to Eliminate the Prohibition on Common Ownership of Cable Television Systems and National Television Networks, MM Docket No. 82-434, 7 FCC Rcd. 6156 (1992), at ¶13 ("[C]able service has benefited from vertical integration between cable operators and programmers, and... cable subscribers have benefited from MSO investment that has generated more original programming and a wealth of new viewing options for consumers."); Report to Congress, 5 FCC Rcd. 4962, at ¶83 (cable investment "rescued" the Discovery Channel).[10]

In addition to creating or sustaining new national programming services, cable investment has added to the diversity of regional and local programming. Regional sports and other "niche services" have been among the "primary growth areas" in cable programming in recent years. Report to Congress, 5 FCC Rcd. 4962, at ¶3 n.8. Cable operators

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[10] In the words of Robert L. Johnson, President of Black Entertainment Television, cable television investment "has done more to create minority programming and diversity in television than all FCC regulations and broadcasting outreach programs combined." Media Ownership: Diversity And Concentration: Hearings Before the Subcommittee on Communications of the Committee on Commerce, Science And Transportation, 101st Cong., 1st Sess. 221 (1989) (Statement of Robert L. Johnson).

increasingly are investing in regional and local news channels and other local programming. Id. at ¶44 n.88 ("award-winning local programming" of Continental Cablevision of Western New England). As recognized by the National Association of Broadcasters ("NAB"), cable operators have provided "numerous unique services and niche programming which could not otherwise be made available in most markets." Report to Congress, 5 FCC Rcd. 4962, at ¶44 n.88, quoting NAB Reply Comments, MM Docket No. 89-600, filed Apr. 2, 1990, at 2. Because cable operators have taken the risk and invested in new and unique program services when others would not, cable subscribers have a wider selection of higher-quality programming than ever before.

The legislative history of the Cable Television Consumer Protection and Competition Act of 1992 ("1992 Cable Act") confirms that Congress had "no desire to regulate programming." First Report and Order, MM Docket No. 92-266, 8 FCC Rcd. 5631 (1993), at ¶8. Consequently, Congress "suggested that the Commission...avoid unnecessary constraints on the cable programming market" in developing regulations to implement the rate provisions of the 1992 Cable Act. Id. Because of the importance of programming and the benefits of vertical integration to programming quality and diversity, the Commission has sought to "balance" its regulatory concerns "with the objective of preserving the benefits and efficiencies of vertical integration and encouraging continued MSO investment in new video programming services." Second Report